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Method In Investment

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Method In Investment

BY

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New York

The intelligent investor seeks the best method of securing the best return from the best securities.

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INTRODUCTION.

My associates and many of my other friends have been urging me to put on paper my theory of investment. I have tried to do so because I believe that few individuals possessing a more or less regular income and a desire to invest it without long periods of delay have a really effective method in making their investments. They have no definite studied plan. They have but little definite knowledge of the often obscure, yet ever present forces that effect future prices and future values. They do not understand the tracks these forces make nor the signs by which they can be determined. I shall show later that in the short swings of the stock market, prices may be going one way while values are tending in the opposite direction.

Unfortunately, such investors usually wait until the newspapers and banking houses are very bullish. Then they buy stocks or bonds and it is probably on the high point for months. Too often the position of our press is governed by the market manipulators; our papers are by nature bullish, and after an advance in prices they become most outspokenly so. At such times the market usually turns back for a few weeks at least.

If the investment banker is questioned, he gives his advice as regards the securities which he has

for sale. Such advice is in many cases satisfactory. The bankers who give their best judgment and attention to each client's individual need, should reap their reward.

How many readers are able to scan a balance sheet and earnings statement intelligently? Many statements are as Greek even to the expert. I find men taking some *one* figure and deceiving themselves into thinking that, as that figure is favorable, the rest of the statement must be.

Investments need watching, exactly as one's own business does. It is our business to know about any company we are interested in financially, even though we place the responsibility of operation upon other shoulders.

The ever-recurring questions presented to the average investor read something like this:

"I have some money now. How can I invest it to best advantage? Is it better to buy bonds or stocks at this time? What particular securities are cheap now? Can I invest to best advantage now or ought I to wait two, three or more weeks?"

These questions I have attempted to answer, and I hope that these few chapters may be of assistance not only to those whom I serve as investment counsel, but to all my readers. My recommendations are simply that every investor should have a definite plan or method to guide him, even as in his business, and not to invest spasmodically or in a haphazard manner.

My theory of investment is greatly assisted by

and almost necessitates a study of the transactions in securities on our stock exchanges, the same plan that is used by the most careful speculators. I refer to those who operate in the ten-to-twenty-point swings.

But I shall not mention the speculators, in any way except to give the reason why so few come out ahead of the game. Men of little experience desire and expect to make 100% in a month or two, or some other abnormal acretion in capital. This very desire for excessive return with little effort on their part breeds the very cupidity which eventually leads to overtrading. "The appetite grows with what it feeds upon." Overtrading causes more failures in speculation than any other thing. The height of overtrading coupled with an entire lack of intelligent foresight defines gambling in stocks. The successful man in Wall Street is the one who expects a 10% to 20% return on his capital in one movement of several months; the man who can control his will—the calculating, careful man.

Examples of the Westerner and Southerner teaching Wall Street a lesson are very common. One of them was a southern mining operator, who a few years ago sold his coal and iron properties for $3,000,000. Instead of teaching a lesson, he paid every cent of this for his lesson.

In this book I disregard the dictionary definition of investment and shall consider it *the use of capital in such a way as to obtain the best return*

consistent with a high degree of safety. Such a definition eliminates from the category of investment at once all securities issued by new untried companies whose officers do not see fit to give the truth, all the truth and nothing but the truth as regards their securities. Such offerings, unless placed by houses of the highest standing, should be scanned to see whether they promise wonderful returns and perfect security; whether they discourse on the points which appeal to the eye and emotions, rather than to the intellect. Such promoters know that success is a stimulus immeasurable, and they use it for all it is worth.

The state of Kansas has come to recognize these features and it requires that a promoter or salesman secure what really amounts to a license (see following page), giving him permission to advertise and sell a certain security. In no way does the state guarantee that the security offered is good, but state officials in charge do make an investigation and secure sworn statements on a few of the vital factors. Thus the fake stock-promoting schemes are kept out. The farmers have been very easy, but they are learning to demand the state certificate and in other places to demand the information that that certificate stands for.

Inquiries on any point made in this book, which are not clear or not thoroughly elaborated upon, will be gladly answered by personal correspondence.

EDWARD W. SHATTUCK.
24 Stone Street, New York.

STATE OF KANSAS

J. N. Dolley,
Bank Commissioner. (Seal)

BANKING DEPARTMENT

F. J. Partridge,
Assistant.

This Statement is to Certify, That *John Doe* has been duly registered with this Department, according to the provisions of House Bill No. 906, Session Laws of 1911, which became a law and went into full force and effect on March 15, 1911, as agent of

John Doe Mining Company
of New York City, New York,

which Company is permitted to do business in this State under the provisions of the above-named law, and such registration entitles said agent to represent said Company as its agent until March 1, 1912, unless said authority is sooner revoked by this Department.

But this Department in no wise recommends the securities of the above-named Company offered by such agent for sale.

In Testimony Whereof, I have hereunto subscribed my name.

Done at Topeka, Kan., the 20th day of December, 1911.

J. N. DOLLEY,
Bank Commissioner.

A sample of the stock-vendor's license issued under the so-called "Blue Sky Law" by the banking department of the State of Kansas.

Distribution of Investments

THERE is a largely advertised English theory, called the geographical distribution of investments, or an equal distribution in each of the leading countries of the world. Those who believe in this theory argue that the returns on investments, geographically distributed, are likely to average better in the long run than if capital were employed locally—that is, in one country—because the same factors are not working in all countries at the same time, but rather different ones, so that some countries are in a period of ascending prosperity while at the same time some are the reverse. It is directly antithetic to Carnegie's advice to place "all your eggs in one basket and watch the basket," but this contains more of the elements of speculation.

If we were to take a single country for our investments, it would be hard to find one where security for capital is greater than it is in this country, or where a geographical distribution is better possible in a single country. The present political differences represent merely the uneasiness of a new generation of voters, a situation the like of which existed twenty years ago. We cannot help believing that the country will continue to grow, regardless of politicians. Although

it may not grow as fast as some countries which are even newer than ours, nevertheless, any American considers that the government of the United States is on a much more stable basis than those newer countries and that its natural resources are still capable of wonderful development.

Need of Investigation.

Then, too, we can watch securities in this country much better. This includes the securities of western cities which need just as careful attention as if they were in South Africa. If the yield on a bond of a western city is very high, there must be some sound reason for it. Perhaps the city is over-grown; perhaps it has only one or two leading industries; perhaps the bonds are special assessment bonds and have as security only one or two streets with their abutting property. Local conditions are always peculiar and should be understood thoroughly by the investor, or by an advisor who is not interested financially in selling those securities.

One of the reasons for the irrigation bubble was the fact that people lost all ordinary business caution, and overlooked the fact that promoters were banking almost entirely on the future. The carelessness of investors is most commonly shown in the way they are led to take up these new security offerings. Irrigation bonds may be the fad; rubber stocks may have developed an hys-

teria—really speculative—which sends prices skyward. In Italy automobile stocks have been very much over-done. All of these securities are popular for a time, and with their popularity, a great advance in the prices comes, but the smash eventually follows.

Stock Movements.

Like all other countries, our country has its period of boom times, followed by a period of depression. These may be regarded merely as a matter of action and reaction. One must follow the other. *Stocks purchased in trade depressions are obtained almost invariably below their intrinsic value.* The earning power of the properties they represent is retarded, and that is used as a gauge for security prices, although the value of the physical property has not declined.

Stocks purchased in boom times are obtained almost invariably at far above their intrinsic value. The attached chart shows the fluctuations of a group of securities. The main point to grasp is the fact that active stocks recede just as much below their real value in bad times as they advance beyond it in good times. If we have a speculative hysteria in the good times, we cannot get away from the panic which must follow in the bad times. *Then, too, as the general movement of the big swings in prices lasting several years is mainly caused by changes in business*

conditions—just so the movement of the smaller swings is governed largely by the position of the speculative operators. The study of transactions, through which they must operate, together with the study of money rates and a careful analysis of current news, makes possible the correct determination of the big operator's position a good majority of the time. Stocks do not move in unison. Some fluctuate more than others, and western rails dependent on crops may drop off many points, when eastern roads are little affected and local public service corporations perhaps advance. To pick out the best possibilities is therefore work for an analyst—a specialist on investments.

There are those who consider that in boom times an investor should hold his money; that, in fact, there is only about a month out of every two to four years in which to purchase stocks. The rest of the time, they say that money should be saved and held for the coming period of extremely low prices. By the operation of this plan, much interest is lost. The lost interest amounts to from ten to twenty-five per cent. upon the purchase price of the security, and to be on a par with any plan where no interest is lost, an average purchase price that much lower must be secured. It is very difficult to tell when the bottom of a two or three year swing is actually reached, and if one is fairly near right, only three times out of five, he does very well. In the meantime, a lifetime has been

consumed. During the years which he misses, he will probably overwait and have to purchase at a price by no means low. One could readily average a low figure over the whole period, if he purchased around the bottom of the various smaller movements, as the law of averages would help him. Not knowing whether we are in a big bear market, it is better to place part of an intended commitment at a fairly low price, so that if it proves to be the low of the big swing, success will result.

Investors who receive capital at regular periods, and who desire to reinvest it at once, do so too often without method. By depending entirely on newspapers, they take big chances. A study of the financial columns for a considerable period will show that the newspapers are optimistic whenever there is any excuse for it; and they are the most outspoken about improving conditions after a considerable advance, when a turn backward is most likely. This may work fairly well in a long bull market, but hardly so in a period of distribution and the subsequent bear market, for papers influenced by the distributors are then even more bullish.

Suffice it to say about bankers and brokers that their relation with their customers is the same as that of the grocers, the plumbers, the druggists or any other traders. Many give their best attention and judgment. Others limit their recommendations to commodities upon which they make the biggest profit. But competition is active and

breeds good service, if demanded. It is one of the strange coincidences of the brokers' lot in particular that some of them can hold the trade of a buyer, even if they treat him unfairly, while others lose a customer's business, through no fault of their own, but rather through a misunderstanding, due to ignorance or suspicion.

The market should be judged largely by itself, by the transactions which make it up, by the demand for money, and by the news, carefully analyzed. These are particular features of my study of the market that will be given attention in the last chapter. Why is it worth considerable money to an investor to receive an unbiased report on these current conditions of the market? Take for example the month of July, 1911; during this period the newspapers and most of the banking houses were very bullish. A purchaser who bought five shares of United States Steel common and five shares of Union Pacific common during that period would have paid about $80 and $190 per share, respectively. About two months later these stocks sold several points below $55 and $160. His income would be increased by over 25%. In other words, the same capital would have purchased at the later date six shares of Union and seven shares of steel, instead of five shares of each. In this small transaction involving $1,350, he would have saved by waiting a few weeks, $275.

This is a case where a study of transactions

and of the money conditions, and a careful analysis of the news showed that the big operators were selling stocks; and the investor should have waited.

In the same way that investors buy stocks in general when the current advices are most optimistic, just so do they buy the article that is most advertised. Not only does the advertisement of a big issue cover much paid-for space, but the wide-awake advertising agent always gets into the news columns a glowing story of his proposition. Manipulation not only in the stock market, but in the news columns, precedes the advertisement for a period of several weeks, for the purpose of giving favorable impressions when it does eventually appear. This custom of subsidizing the reading columns of the press is a disgrace. It is not confined to the sale of good and mediocre security issues, but includes the doubtful and bad. It does not influence the experienced investor as much as it does the inexperienced. Surprising as it may seem, the religious journals contain the very cheapest class of financial advertising.

Bonds as Investments.

What should one do with his capital when stock prices are abnormally high and when the best class yields only a very low rate of interest—even less at times than interest on high-grade bonds?

Bonds are the logical alternative at such times;

and first, I will briefly name the qualities that render bonds suitable for such investment:—

(1) Stability of price.

(2) Security as to principal and interest.

(3) Marketability of bond or convertibility at any time into cash.

(4) Good net yield on investment.

A bond having one of these four qualities in abundance is, without doubt, lacking in some other quality. This is an axiom with bankers, and little understood by investors. For instance, a readily marketable bond will not yield as good a figure as one which has no ready market, although principal and interest may be just as well secured.

Investors in Two Classes.

In taking up the question of bond investments, I shall divide investors into two classes:—

(1) Those who buy to hold permanently and who do not intend to sell out at any time for the mere purpose of re-investing.

(2) Those who give considerable attention to their investments, and from time to time, re-invest in securities in which the possibilities of improvement in price are greater.

The investor who buys securities and *considers them a permanent holding* should not be especially interested in holding readily marketable bonds. Of course, there is always a market for *unlisted bonds* at a price, but this price is often five, or

perhaps ten, points lower than the purchase price, due to the fact that the selling expense is so great on this particular grade of bonds. The very fact that the market is limited, allows a better return on the investment. Ready marketability is worth several per cent. of the par value, so an inactive bond should be purchaseable that much below an active bond of no better security. There is a difference of several points in the bid and asked prices of bonds of a limited market. There is a difference of only a fraction of a point in the bid and asked prices of bonds of an active market. A safe rule therefore is to refrain from any exchanges of bonds, except on a basis of genuine bid prices—not asked prices.

The business man, who expects to use his bonds for security in case he needs to borrow money, should purchase active bonds currently quoted on the exchanges.

The persons comprising Class two—*who give considerable attention to investment*—should be willing, when stock prices are low, to exchange bonds for stocks, and when stock prices are high they should sell stocks and purchase bonds whose primary feature is stability in price and a ready market. When active listed bonds are purchased, care should be taken to secure bonds that always have a ready market and whose fluctuations are within very narrow limits. In this way, when the stock prices are very low, such an investor can sell his bonds at perhaps five

or ten points below the purchase price; and then buy stocks which are 50% or more below their high prices.

An investor logically asks why, if the bond will probably decline in price some ten per cent—why would it not be better to deposit the funds in the bank.

In the first place, enough interest would be gained to make the investment in bonds at that time practically pay for itself.

Furthermore, it very much diminishes the temptation to reduce capital to satisfy immediate desires. It thus protects funds from impairment. The necessity for a majority vote in three-fourths of the states protects the national constitution from a hasty change. It takes more than an undigested popular opinion to amend it; it requires mature thought. The investor will not take the trouble to sell a security and buy an automobile, as quickly as he will draw a check without any effort to do the same thing. It is human nature to follow the path of least resistance. If capital remains uninvested and therefore unprotected, the emotion of a moment is likely to carry forward some plan of luxury, which upon mature thought would be regretted.

Then, too, money standing in a bank during times of great prosperity may be very detrimental to the steady growth of the nation. Hoarding at that time would serve economic purposes better. In case the funds represent business profits

or current income from investment, and come from other bank deposits, its hoarding has a slackening effect upon excessive loans. But if the deposit represents profits from foreign trade, it becomes a basis for additional loans and increases the menace of credit over-extension, always apparent during such periods. Apparently it is liquid capital and is used for current business requirements. Actually it is fixed capital, or will be turned to that purpose during a subsequent reaction in business when stock prices warrant reinvestment. Such a deposit, therefore, brings additional distress upon the industries of the nation, in the subsequent period of depression.

Short-term notes or commercial paper are also very acceptable investments in a high market, although they should be issued by a corporation of highest credit and should represent mercantile transactions. It is difficult to secure the best grade paper, as the banks are always on the lookout for it, and it is usually in large denominations.

Securities in Ten Divisions

ANYTHING based on the law of averages has a most stable foundation. The business of our prosperous insurance companies is an example. In some such way, investments should be based on the law of averages. All of one's money should not be tied up in unmarketable securities of great potential value; nor all in rails; nor all in industrials; nor all in public service corporations; nor all in mining companies; nor all in real estate or real estate trusts; nor all in government securities; nor all in bank or insurance company stocks. The only exception could be the matter of a personal business in which investment is coupled with personal services and attention.

Investments should be distributed geographically and subject to different industrial conditions. Their value should not depend on the prosperity of any one class throughout the entire country, nor all the classes of any one section, except where one confines himself to his own district, with which he is perfectly familiar. In such a case, there is no objection to local investments exclusively, if the district affords sufficient diversity of opportunity.

There are ten main divisions of securities in

this country. These securities move in price more or less in unison, and this is especially true of the active railroad and industrial stocks. The few public service corporation stocks are governed more by local conditions as regards the short swings of several months and only move with the others on the long swings of several years' duration. Few mining stocks are listed in New York, but Amalgamated, American Smelters and Utah Copper move in general with the rails and industrials—although governed to some extent by special conditions. The principal market for other copper stocks is in Boston, in the same way that the principal market for grain is in Chicago.

The prices of the principal listed stocks move over a big average range, as shown in the appended statement of averages. During the big price swings of about twenty years, business has a period of prosperity and a period of depression. *The minor swings of several years are governed by action and reaction of business. The price movements of several months' duration are governed by the position of the big manipulators, operators and investors.* The men who buy from hour to hour and day to day make up the class of men, and oftentimes women, who stand over the ticker as men and women stand over the roulette table in Monte Carlo. This class changes rapidly, and its members invariably lose, not only in a

financial way, but in due time physically and morally.

I believe that on the average, the best return from investment is made not by purchasing stocks only at the low point of the price movements of several years, but by purchasing currently, as one has funds, securities which are, at the particular time especially cheap—perhaps bonds and perhaps stocks. Such investment, of course, should be subject to the development of several localities and of several industries.

Except in boom times, there are *some* stocks which are exceptionally cheap, and they can be located by one who has the facilities and time to search over the entire field. He can find them just as surely as the dealer in real estate can place the land of greatest potential value.

Investors should purchase stocks when the big operators are accumulating. If ready for investment when a careful study of transactions, loaning rates and an analysis of the news shows that the operators are selling stocks, they should wait a few weeks. At all times they should ignore the newspapers. Their columns are usually intended for the day-to-day trader—not for the investor. And when the newspapers become most outspoken in their optimism in regard to securities, it is safe to say that one should never purchase stocks. Every investor should act independently, buying stocks when he considers the price low and buying

bonds of a stable character when stock prices are too high.

In this way a low average purchase price and yield of over 6% should be made with perfect safety, and I mean "with perfect safety," unless this whole country of ours with its fine industries goes into bankruptcy. The securities to be taken should include only the strongest stocks and bonds.

Ten Divisions:

1. Railroads.
   a. New England and Middle Atlantic Group.
   b. Southern Group.
   c. Central Group.
   d. Western and Transcontinental Group.
2. Local Public Service Corporations.
   a. St. Ry. and Traction.
   b. Gas Lighting.
   c. Electric Lighting.
   d. Water and Water Power.
3. Industrials.
4. Telephones and Telegraphs.
5. Steamships.
6. Mining (Principally Copper).
7. Real Estate Trusts.
8. Banks.
9. Insurance Companies.
10. Government and Municipal Bonds.

Railroads.

I regard railroad securities as the class which can be analyzed with the greatest certainty that one's conclusions are correct. There are enough statistics available to show the policy of the company and, taken with a present-day knowledge of the road as it is, its equipment, its traffic, and its regular monthly earnings statements, one is very well able to judge what the securities ought to be worth. The monthly earnings statement is an important feature. Publicity is one of the great safeguards. Too few people realize this, especially those who can be tempted to consider new offerings where the figures given are the prospects rather than the actual performances of a company.

Public Service Corporations.

Investors should confine their interests in public service corporations to propositions in localities with which they are perfectly familiar, or to companies which court publicity rather than run away from it. Only the weak are afraid to have their actions made public.

There are now some holding companies which own local properties in the different leading cities of the country. Some of these companies are very much over-capitalized and bank largely on the future, but their principle is right, as it is based on the law of averages and on the fact that

failure in one community does not largely affect the grand total of all the companies.

This lament comes from a copy of the Manufacturers Record issued at Baltimore:

"The South Throws Away Money.

"As though there were not sufficient opportunities in the South for the investment of money, it is said that many Southern and Western people have lately been completely taken in in the purchase of town lots on Long Island. If the people of the South would only retain at home the millions of dollars that they annually throw away in wildcat schemes of one kind and another and widely-advertised, wonderful world-revolutionizing patents, in playing the cotton market in New York, where they are constantly artistically skinned, this section would get rich very much more rapidly than it is doing."

The franchise of a public service corporation is one of its very important assets. For the most part, a franchise covers a period of twenty to fifty years. Bonds of such a company should always mature several years before the important franchises. The holder of stocks should regard the special privileges of a franchise in the same light that one regards the premium on a bond. This is charged off from the interest received, so, as the bond nears maturity, the price tends toward the par value. In the same way, the value

of the stock tends towards the value of the property at the date of maturity of the franchise, either as it could be sold to the city, or its value under a franchise without special privilege. Stocks of companies which are habitually in trouble with the city in which they operate should be left alone as an investment, unless the security is selling at a figure which discounts all possibilities.

Franchises usually allow for competition or else for regulation, and sometimes, as in the case of the street railways in Chicago, for purchase by the city, under a specified valuation. As long as the terms are definite and known, all is well, but otherwise under our political system, sudden changes are likely to occur to affect the stock vitally, and perhaps the bonds. Sudden changes for the better are few. The growth is gradual and pretty sure. Big changes in this class, when they come, are always on the wrong side.

Public Service Corporation bonds are, for the most part, of the inactive class, yield around 5%, and are often good investments for the man who buys as a permanent holding. It is not usually easy to sell them at the cost price, unless bought under unusual circumstances. The exceptions to the rule are the listed securities, issued by the companies operating in our largest cities—such as Consolidated Gas Co. of New York, People's

Gas Light & Coke Co. of Chicago, and Massachusetts Electric Companies of Boston.

Public Service Corporation stocks often represent merely the promoters' expense and profits and not real money. A prospective investor should, therefore, know the situation and use his practical business sense.

The New York street railway situation is an example of the dishonesty which lack of publicity breeds. Human nature is the same everywhere. The humble farmer does not differ very much from the millionaire. Both have their ambitions and are more likely to be dishonest if they think they will not be detected—or, in other words, if publicity is the exception, rather than the rule.

Gas and electric companies should have large depreciation accounts and unless they do, the company is sure to go on a downward path.

Water companies usually have steady earning power. Possible competition from the city should be allowed for in the terms of a franchise.

Water power companies might come under this category. New propositions of this character are almost as speculative as mining companies. The management is a very essential feature. Even the law of averages does not take account of the sudden onslaughts of nature; and a dam or runway built for average conditions or for the worst conditions in ten years does not allow for extraordinary storms, long periods of drought, or long periods

of immensely cold weather. New records are continually being made. Insurance against flood and breaking of dams is not in vogue; and when a flood carries away the dam—the most valuable part of a water power property—it destroys outright a very large equity behind the securities.

Industrials.

Factories used to be the personal property of individuals. Many remain so. But the economic tide towards combination has been such that partnerships have not been as satisfactory as corporations. This has brought forward the honest promoter of great ability as well as the unscrupulous promoter. Both see future profits, one with a clear eye and one with a glass darkly. Both capitalize the future, and one usually makes good, where the other does not. In a word, that is the position of our industrials to-day. Regardless of control of prices, combination up to a certain point works for greater economy, and the economy represents either (1) salaries of men who are not needed, or (2) greater efficiency in using the services of men, or (3) savings of waste material, by-products, etc., possible only by operating on a very large scale, or (4) saving in purchases. These savings are genuine and the profit to the company is actual. If an organization can by unity of action exclusively control both the cost price and the selling price of its product, we term it a

monopoly. Because a company is large, it is not necessarily a monopoly—nor because it controls over 50% of the trade. That is not logical.

Now—are stocks, representing combinations, possibly monopolies, good for investment? The leading industrials are combinations of some kind, and many of them have doubtless been law-breakers so far as the Sherman law is concerned. Only those should be purchased which are below their intrinsic value, and this is exceedingly difficult to determine owing to the multiplicity of factors involved.

Next to capitalization and financial condition, the most important factors as regards industrials are (1) whether the article of manufacture is a necessity or a luxury; (2) whether a lowering of the tariff would weaken the company's position; and (3) whether a monopoly or a control of prices is essential to the present earning power. Many men are more particular when buying a raincoat than they would be in purchasing rubber stocks. We know there are very great profits and somehow suppose that the owners get large returns. With ten times as large a capitalization as there ought to be, one should not be surprised at the insignificant return.

Telephone and Telegraph.

The few *telephone* and *telegraph* companies are subject to the several-year swings, being prosperous or less so in accordance with the average bus-

iness of the country. The fluctuations are not very great because the earning power can be estimated pretty accurately. These stocks are held largely by investors.

Steamship.

The popular heresy that *steamship* subsidies would not be worth the plum they offer to politicians and capitalists, has kept the subject out of question now for many years. President Taft is frank enough to say that a merchant marine cannot be built without them, if it is to compete with the subsidized foreign companies. Some day we may have enough pride to mend our ways in this matter; but at present our entire fleet consists of only a few coastwise lines, a very few ocean lines and several lines on the Great Lakes. Most of the bonds issued by the inland companies are secured by a mortgage on the individual boats. The mortgage should have a 10-to-20-year sinking fund provision, and the boats should be insured above the amount of the mortgage. When bonds are secured by mortgage on all the company's property they have the law of averages with them and, provided with a generous sinking fund, should be fair for permanent investment. Such companies are easily subject to competition and their securities have no ready market.

Stocks of these companies are very speculative. With two exceptions, they are not listed and have

a very narrow and erratic market. Suffice it to say that the stocks are a good purchase only for one who has first-hand knowledge of the peculiar conditions.

Mining.

The silver and gold mines whose securities are offered would well be eliminated from discussion at once. New offerings are almost invariably of a very cheap character. Promises are abundant. Results are few. The working mines are not being offered for a song. Of lead, zinc and smelting companies, there are a few listed in Boston.

Of copper companies there are many—good, bad and indifferent. The speculative nature of these, it should be understood, is present—no matter who the directors are, and regardless of the location of the property. Calumet and Hecla in its youth looked hopeless and sold at prices which showed it. The late Professor Agassiz of Harvard University had the perseverence and the geological knowledge to stick to the company, and he made good, wonderfully good. But had he tried some other property he might have been digging around until his death and not found a good pay streak in it. Such is the vagary of the miner.

Many of the listed stocks represent small mines at present either paying or prospecting. Calumet and Hecla (a lake property) and Amalgamated (a Butte company) represent large groups of prop-

erties some of which must be of great value. These companies also spend great sums of money prospecting for new mines, and much of this money is sunk, never to come up again. The permanence of these companies seems assured owing to their extent.

Another class, including Utah Copper Company, is known as the porphyry coppers. Machinery, improved only within the past few years, has made possible the digging and crushing of very cheap pay dirt. This is of very low grade, merely gravel shoveled and ground. Companies operating these properties are still experimental, although it is believed by some that they will prove to be the most stable of copper producers. As usual, most of them are overcapitalized.

Profits of mining companies can be reckoned on a share basis, somewhat as follows:

Osceola Consolidated Mining Co. in 1910:—

Produced Copper	19,346,566 lb.
Cost, including prospecting, etc., per lb	9.37c.
Average selling price for year, per lb	13.04c.
Profits—total for year	$758,586.00
Profits per share issued	$7.89

Prices of copper stocks are governed very largely by the trend of copper metal quotations. These run in swings of seven-year periods, as shown on the accompanying map. Our best authorities do not feel that the advent of the por-

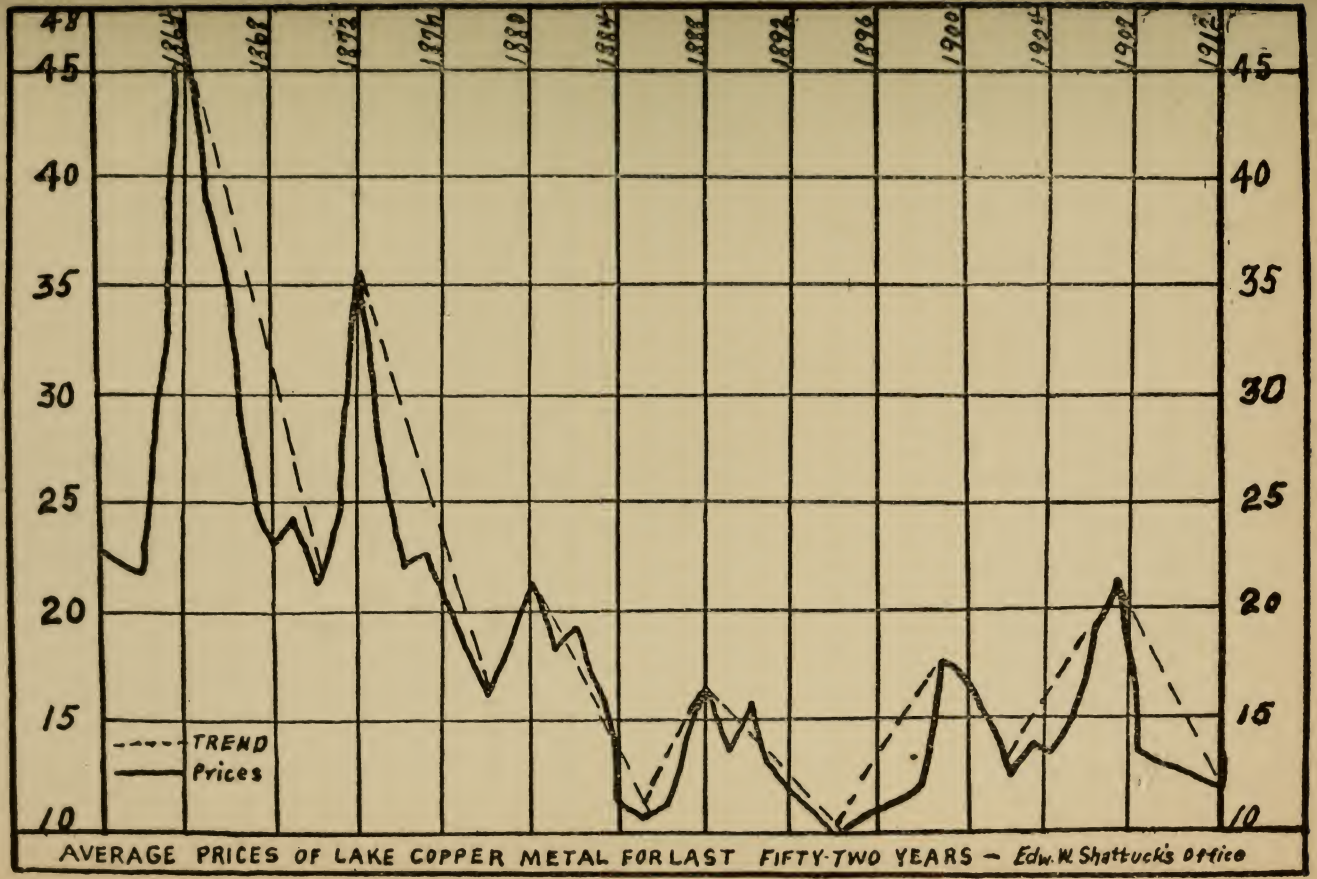
phyry mines will increase the supply enough to permanently affect prices. The increase in demand is steady and should entirely offset the new supply in several years.

Real Estate.

Few, if any, real estate stocks are listed, and but one or two issues of bonds. Savings banks are very glad to take real estate mortgages and those offered to the public have either (1) been refused by the banks owing to over-capitalization, or (2) are secured by large pieces of city property. If the natural conditions are good, the earning power sufficient, and a sinking fund competent, the bonds should be a good purchase for permanent investment. In certain states, such securities are tax exempt, and this ,too, is of great advantage to the holder. The market for this class of bonds is, as a rule, narrow and the price is governed almost entirely by local conditions.

Bank and Trust Companies.

There is a ready market for the leading bank and trust company stocks. The quotations for New York bank stocks are very high, i. e., Bankers Trust Co., over $600 per $100 share; and First National Bank, over $1,000. Stocks selling at such premiums do not help along the cause of a central banking institution, for demagogues will surely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TREND
Prices
AVERAGE PRICES OF LAKE COPPER METAL FOR LAST FIFTY-TWO YEARS — Edw. W. Shattuck's office

say of any plan, that it is by the banks, of the banks and for the banks. If a number of banks stocks were purchased, a rather low average return would be maintained. If the investment were confined to one bank, there would be great possibilities either way, for the fluctuations at times are very erratic. The energy and honesty of the managers is too vacilating an asset for stability, as is also the danger in time of financial stress; and where fluctuations cannot be analyzed intelligently, stability should be a necessity.

Insurance.

Insurance company stocks, if purchased at a fair price, are good investments. Differing from bank stocks, these have very great stability, except in case of the fire companies. The San Francisco earthquake and other big fires are accidents which may be likened in banking to a panic. The life companies in this day of antiseptics and germ statistics are free, to a large extent, from the danger of great epidemics or disasters to the class of men who take out insurance.

Government and Municipal Bonds.

Our Government bonds today are selling on an artificial basis—not on a basis of investment (except the Panama 3's). Any banking plan will doubtless provide a different basis for the currency of our growing country than the fixed, and even contracting, amounts of Government bonds—

the only security allowed as a basis of issue, except in time of panic. The natural yield of bonds of the United States Government cannot be determined until the extent of the demand for them is known, eliminating this artificial demand for currency purposes. For example, quotations of English Consols have declined steadily since '1897 from a basis to yield less than 2½% to a basis to yield over 3⅛%. We cannot tell what our bonds would have done during the same period.

State bonds in this country are of the best for investment, but there are few new offerings and the present issues are closely held. The yield of these bonds, as of all bonds of unfailing security, moves usually in sympathy with the money market. This statement, of course, excepts the government bonds used for circulation purposes.

Municipal bonds, as a class, are the best for purchase when stock prices are very high. It is surprising that during boom times, stocks do not yield a rate higher than bonds. The beauty of investment in municipal bonds at such a time is the fact that when reaction does come with its panicky conditions, there is usually a good demand for the bonds, owing to the fact that money for investment runs to these safer channels.

However, investors should carefully note (1) that the legality of the issue is vouched for by some leading attorney, employed by the banker selling the bonds; (2) that the bonds are not a "special tax" or "special assessment" issue, as

the security is always doubtful; (3) that the bonds are issued by a town of at least 50 years' standing without a default and whose total bonds do not exceed 5% or 10% of assessed value; or else by a city of over 30,000 inhabitants with varied industries; or by a smaller locality, the particulars of which the individual personally knows. Do not consider a western or southern bond, unless the yield is higher and unless you personally know the peculiar local conditions.

Intrinsic Values

Intrinsic Value as applied to stocks, suggests, very likely, to those who have not given the matter attention, a ramification of intricate and technical mental operations, which only the expert may attempt to master. An examination of the term, however, will disclose its comparatively simple freedom from such ramification. It is true that this phase of the general subject of investment affords a broad field for research and study, but nothing within its scope is beyond a clear understanding to the average person. Every purchaser of securities ought himself to know values and what determines them. The country horse trader must know the value of horses in order to be a successful trader in them. It is only common prudence. This simile of the horse trader could be carried further, because every one knows that the degree of his success depends upon his ability to size up the other man, as much as upon his knowledge of what we may call the intrinsic value of horses. Just so the degree of success of the investor depends upon his ability to size up fundamental subjects bearing on securities, as much as upon his knowledge of the intrinsic value of securities. The present chapter will be confined to a discussion of intrinsic value *per se*.

The country horse trader knows horses. After a sort of physical examination of a given animal he can judge very closely what it is worth as a horse—that is, compared with others in the same class. He knows men and divides them, somewhat as he does horses, into classes; only, of course, in respect to their brains or common sense, instead of muscles. He has said that most men, even farmers, know little about the good and bad points in a horse, and that it is an easy matter to take advantage of this ignorance. He was unscrupulous and made money until his reputation became too well known. It therefore behooves one who buys horses for an investment, or to sell again, to learn all he can about horses—as it does for one who buys stocks to learn all he can about stocks.

But to return to our subject, it can be set down as generally admitted that there is no cut-and-dried formula that can be followed in determining intrinsic value in stocks, any more than in the case of horses, because of the great variety and number of factors upon which such value depends. Each stock must be considered with relation to its own particular merits and demerits. But there are general lines of investigation into these merits and demerits that apply to all stocks, so that even the slight knowledge gained in this way would enable one at least to recognize what stock represented an investment and what a speculation. What these lines of investigation are, and how familiarity with them will educate and thus pro-

tect the average investor, I will attempt to set forth briefly and simply.

Stocks and Bonds.

A stock certificate represents ownership in a property or business; but the business may be mortgaged, which would be represented by bonds which must be paid by the proprietors at some future date. There may be two or three mortgages on one division of the property and a single mortgage on another part, these being all different issues of bonds. Then, too, the business may have notes outstanding either unsecured or secured by collateral in the shape of bonds and stocks owned, and these are an obligation of the owners—the stockholders. It is clear, therefore, that if the bonds of a company are worth little, the equity above the bonds or the stock must be worth very little indeed.

Take a property valued at $4,500. If it is mortgaged for $4,000, the ownership of the property is worth the difference, or $500. If this ownership worth $500 is represented by 40 shares of stock totaling $4,000 par value, it is worth only 12½ cents on the dollar par value. But there are also $300 notes outstanding. The presence of these $300 notes tends to make the value of the stock, while the company is solvent, that much less, or only 5 cents on the dollar par value. If the owner failed, his interest represented by the

stock would be preceded by the obligation of the notes as well as of the mortgage.

It is a fact that in receiverships, some such note issues have fared little better than the stock. This is so because failures are usually caused either by lack of capital or by net earnings after expenses too small to pay the fixed interest and rental charges. The purchasers of the property under foreclosure must advance the new capital needed. The noteholders as a rule have been unwilling to take the responsibility, because the total issues are small compared with the total capitalization of the property. Therefore, if the stockholders wish to retain an interest in the reorganized company, they must take the property on a basis which the courts consider equitable to all.

In a nutshell, the above comparison shows the status of any incorporated company. Outside the physical valuation, its value depends largely upon the ability of the property to earn money. Part of these earnings may be put in the bank or spent on improvements, and considered a surplus, and part may be taken and considered as a dividend. Whether it goes to surplus or to dividends, it is the stockholders', and intrinsic value depends more on this earning power than on the amount paid in dividends.

Nothing could be more simple than this. To determine the value of a stock, we must investigate the earning power of the business in which a given stock represents part ownership. No two com-

panies, even if in the same class, are absolutely subject to the same influences. Only general directions can be given as to the determination of intrinsic value. Of course, intrinsic value implies that there is an equity behind a share of stock; in other words, a proportionate share in the property of the corporation above its debts, and this may be pretty definitely arrived at if we know the value of the property. In some cases where the earnings over expenses and charges are little or none, and the possibility of improvement little, intrinsic value represents merely the value of the voting power, or ,in other words, the power to operate the business.

United States Steel.

The intrinsic value of United States Steel shares has been variously estimated from $20 to $60 per share. That is, if the property of the Steel Trust were sold, an owner of one share would receive that much money. But stock is bought, not to receive an actual and proportionate share of the real selling value of the property, but to receive a share in the success and the profits of the business as a going concern. The intrinsic value of U. S. Steel, then, must be determined by the earning power of that corporation, and the earning power, of course, is influenced by industrial conditions, political exigencies and various other factors. At times there is great uncertainty in the minds of invest-

ors, and speculators as well, as to what the future earning power of the United States Steel Corporation will be, because that depends so much upon the outcome of governmental investigation and probable changes in the tariff, although some aver that the Steel Trust no longer needs a protective tariff. Perhaps some who can see through this maze of uncertainties may have reason to believe that the future earning power of the U. S. Steel Corporation will not be impaired, but will grow stronger, in which case they believe that the shares are selling below what they are really worth. In other words, they may believe that the 5% dividends now paid—at which rate the stock at 60 has an income value of 8 1-3%—will continue to be paid, or, at least, be reduced by no more than 1%. Others may be convinced that the government is bent on smashing the Steel Trust, or that, as a result of unfavorable tariff changes, the earning power will be greatly diminished, and that even present prices of the stock have not discounted a future diminished earning power which they believe inevitable.

It is obvious that there are many things to be considered in order to find intrinsic value in any stock, that intelligent and well-informed men may and do disagree as to what that value is. The course of future conditions is subject to certain present conditions. If the real sources of development or retrogression are few and simple, a correct analysis is easily possible. If these

sources are many and complex, an analysis is correct or not, depending largely on the weighting of a very few important items. In such cases, any two individuals are likely to reach different conclusions, although both take all the important sources of change into account. I suppose very few men, who are capable to judge, would dare risk their reputations as prophets by definitely saying that United States Steel stock is at a certain figure selling below its intrinsic value.

In the case of United States Steel, no one knows the values of the immense properties, or how a reduction in the tariff would affect earnings, or how a dissolution of the corporation would decrease efficiency and economy. Then, too, its earnings are subject to considerable variation on account of industrial conditions. All these considerations, and what they suggest, must weigh in determining intrinsic value in this stock. To state that, say between 60 and 70, the stock is protected by sufficient equity in property or earning power, so that it may be said to have intrinsic value at those figures, is to lay claim to a knowledge which it is not reasonable to suppose anybody possesses. By this, we simply mean that ordinary good, sound, logical judgment, with reason which leads to correct conclusions, cannot be exercised with any very great degree of accuracy in cases such as the Steel Corporation presents to-day.

Northern Pacific.

In the case of Northern Pacific, we will see that there are good grounds upon which to judge intrinsic value as we have defined it, without going into details. Northern Pacific has paid 7% dividends for a number of years. Some years have shown large net earnings, others not so large, but always there has been a growing business, because the railroad is in a growing country. The earnings left for dividends have lately fallen off, and there is perhaps some question as to a continuation of the dividend on a 7% basis. In view of this and to discount a reduction in the dividend, the stock sells around 120, yielding 5.83%. The outlook for the railroad as a money-maker is such that the demand for the stock should ultimately increase and the price advance accordingly. That approximately 7% will be earned on the common stock as soon as the competitive traffic over the Puget Sound Extension of the Chicago, Milwaukee & St. Paul Ry. Co. finds its level, is a reasonable conclusion after taking into account the earning power of the past decade, and the outlook for increasing traffic in the future. Intrinsically, then, this stock is worth what it is selling at now, and perhaps more, because there is hardly any question as to the ultimate future of the Northern Pacific in regard to earning power, whatever the immediate future may develop, either as to earnings or stock prices. This is especially true in

view of the timber and ore lands owned by the company.

One who buys stocks below intrinsic values should not be annoyed by current fluctuations.

In respect of intrinsic value in railroads stocks, the foregoing suggests that both previous earning power and probable future earning power may be profitably considered. A business that can show good earning capacity for over ten years, with conditions such that it is reasonable to confidently anticipate good earning capacity in the future, has a basis upon which intrinsic value may be approximately estimated. In regard to Northern Pacific, we made no attempt to show traffic figures and possibilities of increases, stock and bond capitalization and its bearing on dividends, condition of the property as a result of maintenance policy, strategic location of the railroad, comparison with other railroads, and character of management. All of these points and more must be investigated and given their proper importance, but the idea here is more to suggest the range of factors that must be considered. Other books go into detail, and for a thorough handling of the subject are to be highly commended.

Railroad Analysis.

A few of the underlying principles, however, should be mastered. The simplest method is to divide an analysis into headings or subjects and

deduce independent conclusions on these; then assemble these conclusions and make a final deduction, which should be the concrete result of your analysis or comparison. Such an analysis should require only a short time, if the figures and data are easily available. The amount of figuring is not great.

In each of the subjects, not only the present condition and policy should be considered, but also the policy of the company in the past. As a management usually operates on a definite policy, any change in management may cause a change in policy. The fact that Missouri Pacific under President Bush is making large expenditures from income for maintenance, does not mean that the property is in good condition. It may have been bled for the previous decade; and this can be ascertained only by checking the figures over a period of ten or fifteen years.

In taking up one road, practically all the subjects below mentioned should be compared with other roads whose territory and traffic are subject to similar conditions.

(1) *Capitalization:*

Comparison of the capitalization of railroads should be based on the miles of road owned. There should also be a comparison on the basis of total stocks and bonds outstanding, plus leases capitalized on a 4% or 5% basis, minus the value of securities owned. Gross earnings of the railroads in a given territory should bear like ratios

to the capitalization so figured. The effect of competition, contracts, agreements and affiliations through stock ownerships should be studied.

If the common stock of the company only is being considered, the amount of underlying bonds and preferred stock issues should be totalled separately to show how highly the road is capitalized, prior to the stock issue under question. If a bond issue only is being considered, it is important to ascertain the amount of the issues following, and at current quotations their value. This latter figure represents the equity following the issue under question. It is also very important to know whether the bond issue is a direct obligation on the entire system or is secured by important main lines or only by branch lines. Branch line mortgages, not a direct obligation on the system, have fared poorly in reorganizations. Bond issues with a good margin of safety may become involved if the total capitalization is excessive.

An excessive capitalization may be determined (1) by the amount earned on total stocks and bonds outstanding, after adding the other income to the net and taking out rentals paid and hire of equipment, and (2) by the relation of capitalization to gross earnings. The normal capitalization for all practical purposes may be determined by an average of the market quotations over a period of years. This represents the viewpoint of the investor—not the shipper, the public nor the railroad official.

(2) *Gross Earnings:*

Note whether the *total gross earnings per mile of road operated* for the last decade have been gaining steadily, as compared with other roads. It is often the case that the purchase or building of a considerable new mileage changes the line of growth temporarily, but if the capital is increased only in proportion, no heed need be taken of it.

Large passenger earnings do not by any means go hand in hand with stability in total gross. The better developed territories, where passenger earnings are large, have also extensive factory interests, and a period of depression in no small way affects these interests and their shipping. Stability may often be gauged by the diversity of traffic, and the termini of the main lines. A road, 75% of whose tonnage consists of coal, should be subject to violent changes in earnings, if it is not a through line. If, however, the termini or immediate connections are in large cities, such as any tidewater city and Chicago, it is very possible that in time of coal strikes, it can afford to make low bids for higher grade through traffic, which would be very much to its advantage.

There is greater stability of earning power in railroads than in any other form of business, but some roads were so poorly planned in their inception, that the earnings are not large enough to pay a good return on the capital invested. New roads, if considered at all, must always be carefully

scrutinized as to their termini, construction and capitalization.

(3) *Operating Expenses:*

Operating expenses are made up principally of maintenance and transportation expenses. The most important figure is maintenance, being divided under the headings of (a) way and structures and (b) equipment. Careful analyses should be made:—(1) of the total figures for the past decade to show whether the standard is being maintained or whether more maintenance will soon be necessary; and (2) analyses of at least current expenditure to show whether renewals of ties, rails, culverts and bridges are up to the standard. Maintenance of equipment should be compared in the same way for a period of years and also currently for maintenance per passenger car, per freight car and per locomotive.

As no two roads have the same wear on their property, a maintenance figure alone is not valuable as a unit of comparison. The wear caused by freight trains is due to their weight—of passenger trains to their speed. The average passenger, although having only about 8% of the weight of a ton of freight, may well be considered an equal unit to show the degree of wear. So, the best index figure to show the degree of wear on a property is the sum of "*tons of freight carried one mile*" and "*number of passengers carried one mile.*" Divide the total maintenance by this figure

and the result is a valuable index figure, representing the amount of maintenance per unit carried; and this figure should be very nearly equal for roads in a similar territory, although maintenance and tonnage are very different.

The proportion of gross used for maintenance should not be cut, although a high maintenance expenditure for many years makes possible a saving during some single year, if necessary, without seriously impairing the standard of the road.

Average train load is a good check and a high figure should denote well maintained road, bridges and equipment, but a lower figure does not necessarily denote the opposite. A road which features in long haul traffic can average much heavier train loads, except perhaps in case of a commodity of steady demand like coal.

Cost of "conducting transportation" depends upon the degree of efficiency of the management. For the money thus spent, the company receives no permanent benefit. A low percentage of gross used for this purpose represents economy. A contrary tendency represents poor policy or ability, and must be throttled or it will throttle the company.

(4) *Total Net Income:*

Total net income represents the balance, after all operating expenses are paid, available for payment of fixed charges, such as interest on bonds and notes, rentals, hire of equipment and any extraordinary charge.

(5) *Fixed Charges:*

The percentage of gross appropriated for fixed charges should not increase and should leave a surplus from 20% of gross down perhaps to 10%. The percentage of total net consumed by fixed charges, ranges from 50% to 75%. Only roads of extremely regular earning power should be considered if over 75% of the net is consumed by the charges.

(6) *Surplus Earnings and Dividends:*

The proportion of surplus to the gross should be constantly increasing, or at least hold its own.

Note the *percentage earned on common stock,* which is the most interesting of all figures, because not only are the "earnings" considered, but also the "charges" and "capitalization." In other words, if the earnings are increased without increasing the charges or the capitalization, this will show an increase in the "percentage earned on the common stock," which signifies true progress, provided the proper amount is being appropriated for maintenance. If, however, the increased earnings have been obtained by either issuing more stock or by increasing the charges, then the "percentage earned on the common stock" may be no greater, and perhaps smaller, than in previous years.

Note any subsequent item entitled *"other deductions."* Some roads have a second charge for maintenance which they call "extraordinary im-

provements," "betterments" or "other deductions," and when comparing the progress of a road over a period of years or with other companies, the per mile figure for this item should be considered.

It is also of interest to note the *dividends* and the *range of prices* for the past ten years. The "dividend record" is of value in quickly obtaining a general idea of the stability of the surplus especially in case of a company which has paid regular dividends for a long series of years. The "range of prices" is of value both as a suggestion and also in ascertaining the Investment Value. Some students are contented when studying surplus earnings to note only the "percentage earned on the common stock," but this may be carried a step further by ascertaining the Investment Value, which, in the case of a common stock, is the *"percentage earned on this stock, at its current quotation,"* being obtained by dividing the per cent. earned by the quoted price of the stock. The figure for Investment Value is of interest in comparing results of the same company over a series of years, but is of great use in comparing two or more stocks of the same class.

Revenue per Passenger or Ton per Mile:

The type of traffic being the same, the most favorable figures for "rate per passenger per mile" and "rate per revenue ton per mile," are the average figures for railroads in that territory

and not the very low nor the very high figures, because:—(1) If the company is not receiving proper remuneration for its work, it is either severely harassed by competition or else is handicapped by restrictive legislation; (2) if the company is receiving extraordinarily high remuneration, it is inviting competition and hostile legislation. Average figures for rates are not always satisfactory, as the length of haul, the terminal expense, and the class of traffic, are important factors.

Balance Sheet:

The stock and bond issues as shown on the liabilities side of a balance sheet have been discussed above under "Capitalization." On the "Assets" side, the property items offset this capital.

The important feature is the *current account* of liabilities and assets. A large floating debt is a bad sign, unless it is a necessity, connected with new construction. Should it be impossible to pay this, or refund it, trouble would ensue. An item of "advances" as an asset, usually represents money needed in some past time by a weaker subsidiary company, and is usually considered a dead item. Oftentimes the surplus does not represent anything upon which money could be obtained, after current liabilities are satisfied.

A well-known contemporary recently said:—"By an intelligent comparison of the reports of

railroad companies, it is always possible to select the safest of their various securities; and usually it is possible to select the one whose purchase will show the greatest profit. By a careful analysis of the figures published by the railroad companies, it is always possible to decide whether or not said securities are safe and conservative as investments. The great value of the work is self-evident."

Mining.

It is difficult to find out with any degree of accuracy and satisfaction what the intrinsic value of most of the mining stocks are. This is because the future earning power cannot be reasonably anticipated, due to the many fluctuating factors in both mining and selling and the uncertainty as to the amount of ore available. If the ore resources are known and the approximate cost of mining, there is left the uncertainty as regards the purchasing demand for the metals and, therefore, the selling price of it after it is mined and refined. There are some copper stocks which have a history of earning power which, together with probable developments in the future, makes possible a generalization as to their intrinsic value.

John Hays Hammond, one of the very best mining engineers, made mistakes in judging properties, and he has been quoted as saying that every new copper mine or mine of any kind is a specula-

tion pure and simple. In what class should those stock distributors be placed who make some of our substantial country folk believe that any mine is a sure thing. Call them what you will, they are prevaricators, Ananiases, the ever-present barnacles, clinging to the ship of prosperity.

Utah Copper.

In the case of the Utah Copper Company, the extent of ore holdings can be pretty accurately estimated, and they are known to be great; the cost of mining and refining likewise can be accurately determined, and it is known to be relatively small, about 8½ cents per pound. In determining intrinsic value after an investigation of the particular property, the greatest consideration must be given to the condition of the copper business in general; that is, the supply and demand and the probable course of prices for the copper metal in the future. If the price of the metal is very low or seems to be on the mend with regard to the next year or two—if demand seems to be catching up with supply and the future of business which requires copper appears favorable, it is reasonable to conclude that a company like the Utah will receive its fair share of prosperity, which will be reflected in increasing earnings.

Amalgamated.

Amalgamated Copper Company presents another story. The unfavorable arguments over-

bear the favorable ones, even if one is willing to take past history as a fair criterion and forget that present conditions are not at all well-known. Its ore holdings are known to be large, and its prospecting is considered a constant expense. With a property so large, it seems almost sure that new veins will be found of sufficient quality to keep the output at its present rate or larger, for many years to come.

The company's policy has been secrecy, and it is easy for one to believe that this secrecy has been used to good advantage for stock market purposes —I mean good advantage only in a financial way and only to the so-called insiders of that company.

The bookkeeping shows that the surplus of the operating company, the Anaconda, has been reduced some few million dollars within a few years. So from this, taken together with the fact that the company has only paid 2% dividends during a period when prices have ranged from 42 to 96, it appears that current quotations have little to do with intrinsic value or anything else but stock-jobbing tactics. Like Reading, for instance, this stock is boomed time and time again, ostensibly to discount additional dividends or other bonus, only to decline again when it is discovered by the public, that the bonus is not forthcoming and the previous rise unwarranted. Of course, the extent of price movements is shown to a degree through the study of transactions and of the market itself, but only in that way.

Method

MY METHODS are based on three axioms. (1) Stocks as well as bonds, if carefully chosen, are good investments.

(2) Intelligent study backed by experience makes possible, to a degree, a knowledge of the future.

(3) The strongest financial powers make a market for the best securities, and they buy and sell the listed securities mostly through the New York Stock Exchange.

Many readers will say at once that every stock is a speculation. Others will answer that everything on earth, including our every action, is a speculation—a gamble, as they put it. Another will say: "A man who thinks that has been nipped by some fake scheme." The reply will come in a resolute, "Never—but," he hesitates, "I was interested in a company putting out a new patent, a perfectly wonderful thing; and I had some stock, too, in a gold mine in Wyoming, that Mr. Smith, our bank treasurer, knew about. They offered stock to us in the country, because they didn't want the big financiers to get a hold on it." Some one asked what the mine was earning and whether he had received his big dividends. "No, I haven't received any dividends yet, because they are developing the mine, but the stuff is really

there, and I'm going to get it some day without any doubt—Mr. Smith said so." "And your other stock—what of that?" "They have closed down the factory on account of lack of capital, but Mr. Johnson said they would surely make a wonderful showing next year."

It would be an impossibility to show that man that his stock holdings were of a spurious class—the very crumbs off the master's table. They are probably so for two reasons: first, because an offer of fabulous returns is a sign of instability and recklessness; secondly, because a statement of certainty about the development of a prospective mine could not be made truthfully.

But all stocks are not of a cheap class. Their value depends on the equity in the property (or value less all liens and mortgages); on the actual present earning power and its stability; and on the genuine possibilities of the near future.

The simplest example, ownership in real estate, clearly shows that a property valued at $10,000 and earning a good return on that figure should, if capitalized, have securities of total par value of $10,000. If this capitalization was $10,000 stock, it would represent at par the genuine value. If, however, $50,000 stock were issued to represent the value of the property, the value of the stock should not be over 20, or $20 per $100 share. After ten years' development that stock might be worth 100 or zero, depending on the foresight and honesty of the promoter. If a $10,000 property has

$5,000 in bonds, the equity above the bonds, or what is left after the amount of bonds is taken out, amounts to $5,000, whether it is represented by that value of stock or a great deal more.

Now, take a railroad with many millions of bonds and notes. After the interest charge is paid, we will say 10% is earned on the one stock issue. That there is a good equity in value for the common stock is certainly true in this case, if the earnings are stable, and if sufficient maintenance expences have been taken from earnings. Of the various kinds of companies, railroads have the most stable earnings. Take the leading systems of the country for ten or fifteen years, and it is wonderful to note how surely and steadily their gross earnings have increased. To get a stable return for the stock issue, expenses and charges must increase in no greater degree—and that is the difficulty at present. Expenses are taking up too large a proportion of gross earnings; and unless the tide turns, we will see more failures from our big railroads, as the expenses are increasing so as to threaten the payment of interest charges on the bonds or mortgages, and there will be default on their interest payment. While the balance available for interest charges decreases, the earnings on the stock also decrease, and so the value of the stock must decrease to some degree, especially if it becomes necessary to cut dividends. The stability of railroad gross earnings works for great stability in the earning power of railroad

stock issues. Fluctuation in the earnings of industrial companies works for greater fluctuations in the earning power of their stock issues. The general movement of railroad earnings follows the trend of general industrial conditions, and this is much easier to determine than the condition of any particular industrial. Therefore, railroad stocks, as a whole, move with more regularity than industrials, and they are more satisfactory for investment.

Growth of Railroad Earnings (Last three ciphers omitted).

	—Pennsylvania—		——Atchison——		-Louis. & Nash.-	
	Gross	Net	Gross	Net	Gross	Net
1911.....	$163,118	$30,988	$107,565	$38,004	$53,993	$17,534
1910.....	166,433	32,308	104,993	37,781	52,433	19,302
1909.....	153,564	34,004	94,265	37,928	45,425	17,193
1908.....	136,296	28,458	90,617	30,465	44,620	12,346
1907.....	164,812	34,367	93,683	35,568	48,263	14,044
1906.....	148,239	33,882	80,801	31,774	43,008	13,642
1905.....	133,921	28,184	68,375	23,672	38,517	13,654
1904.....	118,145	25,139	68,171	27,197	36,943	13,437
1903.....	122,626	25,756	62,350	25,231	35,449	12,600
1902.....	112,663	26,006	59,135	26,366	30,712	10,810
1901.....	101,339	21,427	54,474	22,544	28,022	10,493
1900.....	88,539	18,216	46,232	18,977	27,742	9,789
1899.....	72,922	11,257	40,513	13,156	23,759	8,568
1898.....	65,603	10,777	39,214	10,889	21,996	7,665
1897.....	64,233	11,247	30,621	8,008	20,372	6,950
1896.....	62,096	9,813	28,999	6,928	20,390	7,319
1895.....	64,627	11,220	28,815	6,501	19,275	7,361
1894.....	58,704	9,384	33,799	8,243	18,974	7,382
1893.....	66,375	9,407	41,316	12,710	22,403	8,437
1892.....	68,841	9,794	38,541	11,790	21,235	7,976
1891.....	67,426	10,997	33,663	9,620	19,220	7,880
1890.....	66,202	10,800	31,004	10,083	18,846	8,065

The twenty rails and twelve industrials used for the daily averages by the Wall Street Journal represent most of the active leading stocks and are as follows:

20 Rails.

Atchison, Topeka & Santa Fe.
Baltimore & Ohio.

Brooklyn Rapid Transit.
Canadian Pacific.
Chicago & Northwestern.
Chicago, Milwaukee & St. Paul.
Delaware & Hudson.
Erie.
Illinois Central.
Louisville & Nashville.
Missouri Pacific.
New York Central.
Norfolk & Western.
Northern Pacific.
Pennsylvania.
Reading.
Southern Pacific.
Southern Railway.
Twin City Rapid Transit.
Union Pacific.

12 Industrials.

Amalgamated Copper.
American Car & Foundry.
American Smelting & Ref'g.
American Sugar.
Colorado Fuel & Iron.
General Electric.
National Lead.
People's Gas Light & Coke.
United States Rubber, common
United States Rubber, 1st preferred.
United States Steel.

United States Steel, preferred.

The fluctuations of the average over a period of years are best shown in the accompanying line cut, and with it is given the record of bond prices to show their comparatively narrow range. The bonds are—

Atchison, Topeka & Santa Fe Ry. Gen. 4's Oct. 1995.

Baltimore & Ohio R. R. 1st 4's July 1948.

Central of Georgia Ry. Cons. 5's Nov. 1945.

Central of New Jersey Gen. 5's July 1987.

Chicago & Alton R. R. (Old Co.) Ref. 1st 3's Oct. 1949.

Colorado & Southern 1st 4's Feb. 1929.

New York Central Refunding 3½'s July 1997.

St. Louis & San Francisco R. R. Ref. 4's July 1951.

Southern Ry. 1st Consolidated 5's July 1994.

Wabash R. R. 1st 5's May 1939.

It is very evident that stocks have greater fluctuations than bonds, and that, wisely purchased, they would show greater net return. To buy at the low point in the long swing is apparently almost impossible. Take the last weeks in September, 1911. Many a keen student believes that period to mark the low prices for a season, perhaps the low prices of the big movement downward. Others say: "Don't buy now; we are going to see much lower prices within a few months." I say that one should invest his current funds for neither of the above

reasons. I do not believe the reaching of the grand low point can with certainty be determined until months after it is turned. The current low points can be, to a degree, ascertained. The average of investments at these current low points will be as favorable a figure as that of the investor who buys once and holds his current funds for several years until another buying period is reached.

I have mentioned "current low points." You will note the intermediate swings on the chart. These extend over a period of three to ten weeks and are governed by the overdoing either way of the market. The peculiarities of this period when stocks are "oversold" and the period when stocks are "overbought" are numerous enough to fill a book, and they would be of no great use here; in fact, they might do harm in creating an impression that it is *safe* to speculate on that basis. Whether it is or not for some people, it certainly is not for anyone unless they make an extremely thorough and careful study of the whole subject, and I will assure you that a few years of this study is not overmuch.

Could you run an airship safely without a period of study and a natural leaning that way? No—but you could sail one, and if lucky enough to be successful the first time, your chances for coming down alive the next time would be small, indeed. Overconfidence is a fault of youth and is easily bred by one or two successes.

The comparison continues with the air expert who knows all there is to learn. His safety depends largely on his knowledge of air currents and the method of running the machine; but even with all possible knowledge and safety devices, he might come to a vacuum in the air—the whole bottom is out of the market—and ,whether he was ready or not, he cannot right himself until he is out of the vacuum. If his balance, which in one case is mental, does not return then, he is smashed, in the one case physically and financially *in toto,* but in the other case partly physically and partly mentally and partly financially.

However, the terms should be explained. When stocks have been advancing for several weeks there comes in more and more buying—and much of this is speculative, and therefore from weak sources. The market would then be called "overbought" and a slight reverse would force back onto it much of this stock. As a result, a further reaction would take place. The same rule works when the market is "oversold"—that is, many traders have sold stocks which they did not own and have borrowed the stock for delivery, or, in technical language, "sold short." This prepares the way for a turn into an advance. Now I am sure that it is possible for a careful student to determine these general turning points three times out of five. The big operators control these swings largely, and it is upon their operations that we put the glass. Ex-

cept in unusual cases, all transactions are traded on the stock exchange, and it is a careful study of these and their connection with the money market which brings the best results.

News—To place much faith in rumors or reports or interviews, is a mistake, although they oftentimes call attention to points which could bear investigation, thus determining the truth of the report. Those who have the facilities for this investigation into the truth of such reports, derive great benefits. For example: In January, 1912, reports were current that a coal miners' strike in March and April would make a deep cut into the earning power of the hard and soft coal roads, or either one, if the strike was localized to the one district. I immediately took a soft coal road, the Chesapeake & Ohio, to find out the effect of the 1902 strike, which included the soft coal fields of West Virginia. To my surprise, although coal constituted 50% of total tonnage in the year ended June 30, 1902, and the following year only 39%, a decrease of 22%, the gross earnings decreased only $300,000, or less than 2%. Fuel, however, cost $400,000 more in 1903, and net earnings were not so strong, although very strong considering what I expected. Unless one gets at the underlying facts—examples of the past under similar conditions—it is impossible to come to any correct decision. There are too many "ifs" to make the judgment of any value.

Another "if" in the present coal situation

comes from the fact that it is international, and dearth of coal in England and Germany may entirely change the home situation.

Of actual and concrete news, we have several kinds: (1) Events that are expected but which are beyond the power of anyone to definitely control, such as elections, conventions, court decisions, laws, etc. (2) Events that are entirely unexpected and unforeseen, and which no one can possibly control, as accidents, fires, earthquakes, etc. (3) Events that are expected, and which, while they may not be controlled, can be manipulated or postponed or so adjusted as to facilitate the desires of certain individuals or concerns; for instance, corporation reports, failures, favorable or unfavorable decisions among directors of an institution, etc.

The effect on prices of the first classification depends largely on the importance of the event, the public sentiment and the power of any factor interested in the result. If it be important court decisions—such as the American Tobacco and Standard Oil cases, or impending laws which no one can foresee, and the results of which are doubtful, the market generally stagnates. This is especially so when public opinion is strongly directed to one result and the people are clamoring for certain reforms.

On the other hand, if the event be an election or convention, where it is possible for extensive interests to estimate the result with reasonable

accuracy, prices will likely be manipulated, so that when the public finally learns the news, prices will already have discounted the situation and be ready for a reversal. When it so happens that the unexpected occurs, enforced liquidation or else purchase of stocks by the big operators becomes necessary, and sharp breaks or advances in prices develop.

In the second division—*unexpected events*—we find that genuine, bona fide news has a sound, rational effect on prices, depending on the importance of the happening and the securities immediately affected. If the event is one that vitally affects several important stocks the entire market is likely to respond to the influence. If, however, only minor securities are affected, the fluctuations would probably be confined to the few securities immediately concerned. In fact, the leaders might even take the opposite trend.

The third division, and the one having the most significance to investors and speculators is *expected events* under the control of influential individuals. Take, for instance, the dates when annual corporation reports are issued. The abuse of this matter in the past has been very frequent. The annual report of Union Pacific was always issued very tardily. Many believe that this helped Mr. Harriman's personal plans very much, but possibly he was justified, as the publication of the new list of securities owned might have caused an immediate change in certain stock quotations. The

benefit from this, however, all went into the pockets of the directors of the companies involved and to others who knew the facts and their probable effect on values. When the public knew it, the report was of no use.

Another kind of news that often has a marked effect on prices, but which is generally circulated for a reason, is *interviews with influential men.* Sometimes these statements are sincere and have an enlightening effect, but more often they are given out to counteract or develop a condition existing in the market. The effect of such news is almost invariably dependent upon the technical condition of the market—whether it is overbought or oversold.

The following statement will probably surprise some and be challenged by others, but nevertheless, it is true. News, of the Wall Street kind—paragraphs on the financial page—is more often the result rather than the cause of fluctuations. In other words, a great deal of so-called news is only rumor circulated to explain some break in prices. The public believes the fluctuations due to these rumors until the real facts become known.

James J. Keene was a very clever operator and manipulator of prices. How did he do it? As much by the manipulation of news as by his care and foresight in trading. Thomas Lawson had his day, and some speculators, and even investors, believe in him now. His following, however, was located very largely out of town and was reached

by extremely sensational news advertising, which cost at times thousands of dollars a day. Someone paid for this advertising, but no well-informed person believes that it really came out of Mr. Lawson's pocket.

The only news that has a logical effect on prices is that which is entirely unexpected, and which no one can foresee. The value of other kinds of news to investors or speculators is practically *nil* or worse. Always judge how long the big operators and insiders have had the facts, for if they have been acquainted with them, prices are doubtless adjusted to discount the change in conditions.

Method.

What, then, is my method, which secures the best return for capital over a series of years?

(1) *Buy stocks when around or below intrinsic values only.* This is necessary for practical reasons, also for mental ones. Stocks should not be considered a purchase, when they are above their intrinsic value. One cannot buy a security at such a price and forget it; he is always on the nerve to see whether he has gauged the future correctly; he is outside of the realm of investment.

(2) *Buy bonds only when the intrinsic value figure of good stocks is exceeded—bonds whose principle features are—*

(a) For the permanent holder—*security and yield.*

(b) For the holder who desires to later reinvest in stocks—*security, but also stability in price and easy marketability* (or convertibility into cash).

The purchaser for permanent holding will secure higher yield with equal security, if he does not demand convertibility into cash and stability in price. As he avowedly does not care for these, the big majority of his holdings should reflect that fact. Investment in bonds is the best disposition of money when stock prices are high. A better yield is secured, and it is steady. Bonds of a doubtful nature should not be purchased, as they are often subject to more violent fluctuations than standard stocks.

(3) *Buy only those securities from the great assortment, which at the particular time are the cheapest,* judging from a study of intrinsic values as explained in a previous chapter. This study should be done by one who does the work purely as a vocation—not an avocation—his day work, and not his night work. Every man who carries his common sense into investments tries to do it as an avocation, and many fail for the same reason that their legal reasoning fails without the assistance and experience of a competent lawyer. Choice of the best purchase requires not only a thorough knowledge of statistical analysis, but also an investment knowledge. It requires both in a high degree, and it is an impossibility with the average

trustee, bank official and business investor. Their duties take up their best energies and time.

(4) *Distribute your holdings over areas which are subject to different conditions, both geographical and industrial.* This is explained in a previous chapter and is founded on the laws of nature, as well as the law of averages. The section of the country dependent on the grain crops may be abounding in prosperity, while another dependent on cotton is depressed; and the cotton crop affects not only the South, but New England industries, in the same way that grain crops affect not only the middle west but, to a certain degree, the manufacturing industries in general. An earthquake in San Francisco or a fire in Chicago affects the local public service corporations materially, as well as the price of the municipal bonds and the securities of the manufacturing companies whose valuable property is destroyed, but neither affects at all the public service corporations in another locality.

(5) *For those who desire to re-invest to advantage:—*

(a) When conditions appear bright and stocks are selling at very high prices, *sell stocks and buy bonds* of good security, of proven stability in price and convertibility into cash.

(b) When stocks again reach a very low level in accordance with the inevitable reaction, sell the bonds and buy stocks again.

(c) Do not exchange one bond for another,

unless under extraordinary circumstances.

Re-investing advantageously is largely a question of temperament. The man who is willing to do it will reap his reward if he does it at the logical time. A sporting man was recently left a small fortune, his only source of income. He found the income too small for his purposes, so he made exchanges for other bonds of higher yield, and did this several times, only to find himself in three years the owner of certain defaulted securities. His re-investment was of the wrong kind. He did it when he needed the additional income, rather than at a time when he could get equal or better security by converting from one kind of a security into another. He lost in principal every time he made an exchange, and, although temporarily his income was enlarged, it made him eventually go to work for a living. When stock prices are at the highest, as shown in the table under (2) above, bonds as a class yield a better return; and at such times a conversion of one's holdings into bonds is advantageous, because bonds do not decline so much as stocks in any reaction to come—and unless a poor selection of bonds is made, the income return will not be reduced. Later, when stock prices are unusually low, the bonds can be converted into stocks again to advantage, because the bonds decline but a few points which is more than paid back by the interest return.

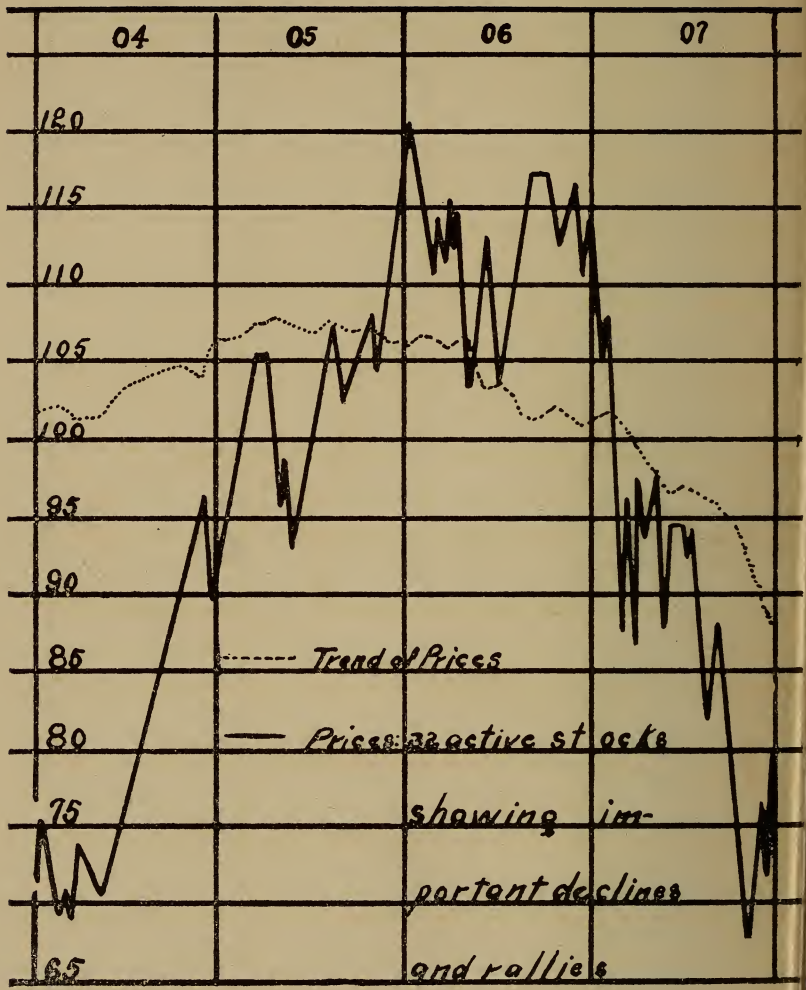
The results from such method in investment give the biggest income returns with the best se-

curity. It is real investment—*the use of capital in such a way as to obtain the best return consistent with a high degree of safety.* The intelligent investor seeks the best method of securing the best return from the best securities.

Bonds.	—Average Quotations— Sept., 1909	Sept., 1911	Loss
Atchison, Gen. 4's 1995	100¼	98⅜	1⅞
Central of Georgia, Cons. 5's 1945	109⅜	108⅜	1
Central of N. J., Gen. 5's 1987	127	123	4
Chicago & Alton, Ref. 3's 1949	78	70	8
Colorado & Southern, 1st 4's 1929	98	95	3
New York Central, Ref. 3½'s 1997	91⅞	87½	4⅜
St. Louis & San Francisco, Ref. 4's 1951	85⅞	79	6⅞
Southern Ry., 1st Cons. 5's 1994	111	105⅝	5⅜
Wabash, 1st 5's 1939	113¼	107⅞	5⅜
Average loss of principal			4⅛
Interest received in two years			8⅛
			4
Stocks.			
Amalgamated	81	52	29
Atchison	120	102	18
Chesapeake & Ohio	84	71	13
Chicago, Milw. & St. Paul	159	111	48
Missouri Pacific	70	37	33
New York Central	135	102	33
Northern Pacific	155	114	41
Pennsylvania	145	120	25
Reading	165	139	26
Southern Pacific	129	108	21
Union Pacific	202	162	40
United States Steel	83	62	21
Average loss of principal			29
Dividends received in 2 years			10
			19

From above quotations it may be deduced that if one of each of the nine bonds had been purchased in September, 1909, and sold in September, 1911, there would have been, eliminating interest, a return of $3.93 per $100.00 invested. The result is secured as follows:—The total loss in market value was $4.50 per hundred dollars par value of bonds. Interest received amounted to $8.50 per hundred dollars of bonds. The difference shows a gain of $4.00 per $100.00 par value of bonds, but these bonds cost in September, 1909, an average of $102.00. Reducing this, the amount of income return for the two years totalled $3.93 per hundred dollars invested.

Taking the listed stocks in the same periods, it works out that if one share of each issue had been purchased at the average price of September, 1909, and sold at the average price of September, 1911, a loss of $14.85 per $100.00 invested would have resulted. The total loss in market value was $29.00 per hundred dollars of stock. Dividends received amounted to $10.00 per hundred dollars of stock. The difference shows a loss of $19.00 per $100.00 par value of stock, but these shares cost in September, 1909, an average of $128.00. Reducing this to a hundred-dollar basis, the loss in the two years per hundred dollars invested was $14.85, plus the $8.00 to $10.00 which should have been averaged for interest.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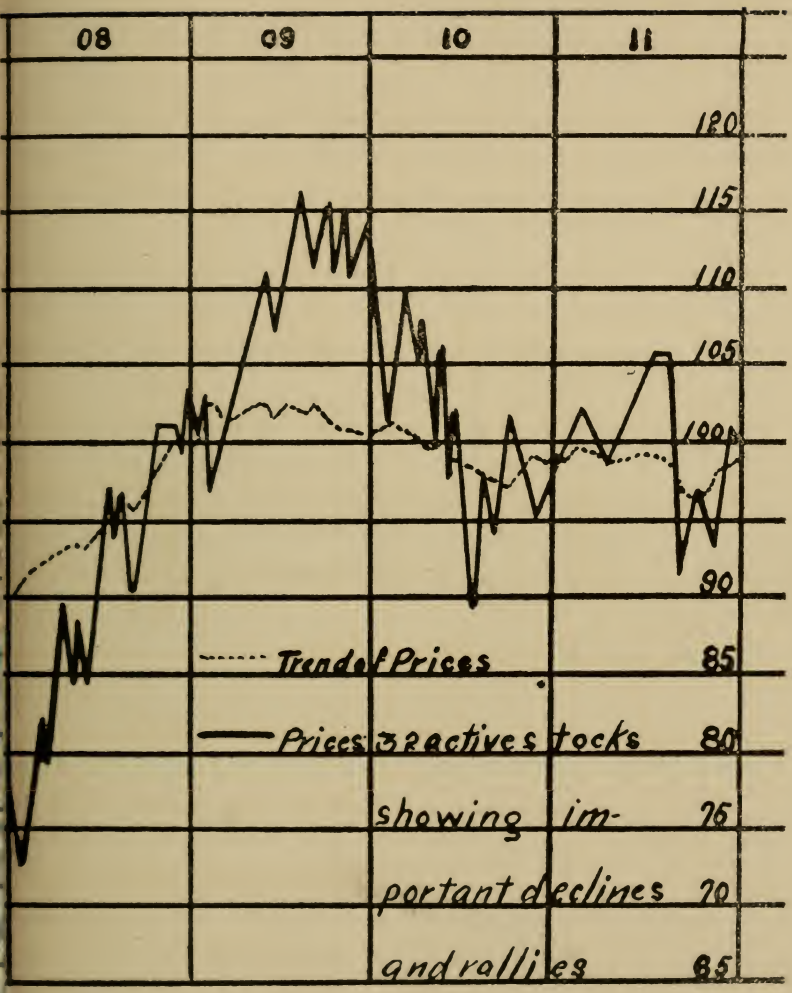
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